

A STUDY REGARDING THE BANKRUPTCY IN ROMANIA. REGIONAL COMPARISONS

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Abstract: The academic world showed a big interest for the study of the companies in financial distress in the last years, due to the implications of the bankruptcy process on the Romanian economy. In this paper, we carried out a study of the main specific features of the bankruptcy in Romania in the period 2003 – 2005. Also, we made a comparison with other countries from the Eastern and Central Europe. The results of this study emphasizes that the trading branches provide the biggest number of bankruptcies in the Romanian economy and also that Romania has a bigger bankruptcy rate than the average level in the Eastern Europe.

Key words: bankruptcy, failure, financial distress, judiciary reorganization

The academic world showed a big interest for the study of the companies in financial distress in the last years, due to the implications of the bankruptcy process on the Romanian economy. The economical growth posted by the Romanian economy at the beginning of this decade and setting the bases for a strong market economy imposed the institution of bankruptcy as a true regulator of the Romanian business environment.

The specific features of the Romanian economy determined a specific pattern for the failures against other emerging economies from the region. The factors that explain most of the bankruptcies in the last years can be found both in the internal and external environment of the enterprises and mainly regard an unsatisfactory meeting of the changing requirements of the market by the products and services of the company. The growth of the people's income and the requirements of joining European Union generated increasing preferences of the consumers for high quality products; but making these products implies both know-how and investments in the operating activity for the enterprises. The low technical and financial potential of many Romanian enterprises, especially SMEs, but also the increasing competition led to the disappearance of many companies from the market, to a concentration of the market and to a consolidation of the Romanian economy.

Within this paper, we carried out a study of the bankruptcy in Romania in the period 2003-2005, on branches of activity, and also we made a comparison with other emerging countries from the region of Central and Eastern Europe.

For the year 2005, the distribution of bankruptcies on branches of activity, in the Romanian economy, is presented in the following table:

Table no.1

The branch of activity	Companies in bankruptcy	Companies in judiciary reorganization	Companies closed due to the lack of assets	Total	Weight
Wholesale trading and distribution	716	41	54	811	22.64%
Agriculture, forestry, hunting and fishing	499	22	66	587	16.39%
Retail trading	383	21	38	442	12.34%
Food and beverage industry	372	17	27	416	11.61%
Textile, clothing and footwear products manufacturing	175	8	10	193	5.39%
Metallurgical industry	111	8	2	121	3.38%
Transports	100	7	8	115	3.21%
Wood processing industry	196	10	7	213	5.95%
Machines and equipments industry	24	1	2	27	0.75%
Constructions	162	7	10	179	5.00%
Hotels and restaurants	78	1	3	82	2.29%
Other activities mainly provided to the companies	109	2	4	115	3.21%
Chemical substances and products manufacturing	80	4	2	86	2.40%
Entertaining, cultural and sport activities	25	1	6	32	0.89%
Real estate transactions	21	2	6	29	0.81%
Other activities of personal services	27	0	5	32	0.89%
Financial services	21	1	0	22	0.61%
Extractive industry	12	1	2	15	0.42%
Post and telecommunications	7	1	1	9	0.25%
Informatics and additional activities	19	0	0	19	0.53%
Wealth and social security	8	0	0	8	0.22%
Electrical and thermic power, gas and water	6	0	0	6	0.17%
Sanitation and trash removing; salubrity and similar activities	20	1	2	23	0.64%
TOTAL	3171	156	255	3582	100%

Source: Coface Intercredit Romania, www.coface.ro

We notice that the biggest weight is hold by the branch of *wholesale trading*, with more than 22% from the number of bankruptcies. At the same time, *the retail trading* holds a percent of 12%, which shows the vulnerability of this sector to the increasing competition from the last years. This branch will post high weights in the next period too, considering the preference of the population for modern trade, represented by hypermarkets, supermarkets, malls. These will determine a decrease of the activity and of the number of traditional enterprises, aligning the Romanian market to the European tendencies.

The enterprises from *agriculture* hold the second place in the bankruptcy top, which is explained by the disappearance of the small agricultural lands, insufficient for running efficient activities. The reduction of the number of agricultural companies is favorably appreciated, as it is followed by the development of big companies in this field or by implantation of big European enterprises. But this trend was only partially visible, because, while the West of the country took advantage of consistent investments in this branch, most of the country still confront with subsistence agriculture.

In *the food industry*, the enterprises have a low capacity to meet the European requirements; thus, the obsolete technologies, the lack of investments in high-tech equipments, a bad implementation of the food safety regulations, the low subsidies against the neighbor countries make this sector one of the most vulnerable in the next period, which will increase the number of bankruptcies.

In *the textile industry*, a strong reduction was noticed in the last years, after a long period of time when it had a high development and contributed to cutting down the unemployment in the economy. By gradually diminishing the main competition advantage, the low wages, the markets were lost for the Asian companies benefit and this led to the reduction of the number of bankruptcies in this field. However, the impact on the economy was not significant, due to the low contribution of this branch to creating value added.

A low number of bankruptcies can be found in *the extractive industry, in the electrical, thermic, water, gas and salubrity*, meaning branches dominated by state owned companies or where the state is the main client or beneficiary. In every economy, these companies have the lowest bankruptcy risk.

A low weight of bankruptcies is also posted by *the financial and IT services*, branches that have a high dynamic of development nowadays and that will continue to have high rates of growth in the following years. The financial and banking market, after confronting big bankruptcies at the middle of the last decade, now have a very good period, with accelerated rates of development.

The next table presents the weight and the evolution of the bankruptcies on branches of activity, in the period 2003-2005.

Table no. 2

Branch of activity	Year			Variation	
	2003	2004	2005	2004/2003	2005/2004
Wholesale trading and distribution	19.30%	20.14%	22.64%	0.84%	2.50%
Agriculture, forestry, hunting and fishing	17.77%	19.69%	16.39%	1.92%	-3.30%
Retail trading	14.83%	12.38%	12.34%	-2.45%	-0.04%
Food and beverage industry	11.89%	13.18%	11.61%	1.29%	-1.57%
Textile, clothing and footwear products manufacturing	5.98%	5.85%	5.39%	-0.13%	-0.46%
Metallurgical industry	4.46%	2.81%	3.38%	-1.65%	0.57%
Transports	4.21%	3.57%	3.21%	-0.64%	-0.36%
Wood processing industry	4.16%	4.04%	5.95%	-0.12%	1.91%
Machines and equipments industry	3.68%	3.06%	0.75%	-0.62%	-2.31%
Constructions	3.68%	3.84%	5.00%	0.16%	1.16%
Hotels and restaurants	3.04%	2.29%	2.29%	-0.75%	0.00%

Business Statistic – Economic Informatics

Branch of activity	Year			Variation	
	2003	2004	2005	2004/2003	2005/2004
Other activities mainly provided to the companies	1.72%	2.69%	3.21%	0.97%	0.52%
Chemical substances and products manufacturing	1.65%	1.98%	2.40%	0.33%	0.42%
Entertaining, cultural and sport activities	0.66%	0.75%	0.89%	0.09%	0.14%
Real estate transactions	0.63%	0.45%	0.81%	-0.18%	0.36%
Other activities of personal services	0.58%	0.95%	0.89%	0.37%	-0.06%
Financial services	0.48%	1.05%	0.61%	0.57%	-0.44%
Extractive industry	0.35%	0.40%	0.42%	0.05%	0.02%
Post and telecommunications	0.33%	0.38%	0.25%	0.05%	-0.13%
Informatics and additional activities	0.30%	0.13%	0.53%	-0.17%	0.40%
Wealth and social security	0.13%	0.18%	0.22%	0.05%	0.04%
Electrical and thermic power, gas and water	0.10%	0.13%	0.17%	0.03%	0.04%
Sanitation and trash removing; salubrity and similar activities	0.05%	0.05%	0.64%	0.00%	0.59%

Source: Coface Intercredit Romania, www.coface.ro

The dynamic of bankruptcies in the three years is not spectacular. We notice the retail trading, which have a decrease, more accentuated in 2004, in contradictory with the wholesale trading, which have a bigger growth in 2005. In agriculture, after a 1.92% growth in 2004, the percent of bankrupt companies decreases with 3.3% in the next year. The enterprises from wood processing field have a significant increase of the percent of bankruptcies in 2005, from 4.04% to 5.95%. For the other branches, the rate of bankruptcies is very low and also the dynamic in the analyzed period is insignificant.

The next table synthetically presents the level and the dynamic of the bankrupt and active enterprises for the period 2004-2005:

Table no. 3

	Year		Variation 2005/2004	
	2004	2005	Absolute	Relative
Failures	2,031	3,171	1,140	56.13%
Judiciary reorganization	25	156	131	524.00%
Closed procedure – lack of assets	264	255	-9	-3.41%
Total bankruptcies	2,320	3,582	1,262	54.40%
Active companies	410,514	525,000*	114,486	27.89%
The bankruptcy rate	0.57%	0.68%	0.12%	

* estimation

Source: Coface Intercredit Romania, www.coface.ro

The improvements brought to the bankruptcy law in 2005 determined an increase of the number of bankruptcies, from 2320 in 2004 to 3582 in 2005. The rate of bankruptcies (against the active companies) grew from 0.57% to 0.68%. The level is still small, considering the big number of enterprises in financial distress that are operating in the economy. However, the changes of the bankruptcy law had

consequences, determining the increase of the number of bankruptcy and there are expectations for this number to increase in the following years.

In the structure, we notice a growth of the number of failed companies (with more than 56%), from 2031 to 3171; at the same time, the companies in judiciary reorganization increased from 25 to 156, which means a relative variation of more than 500%. The number of enterprises closed due to the lack of assets decreased a little, with about 3%. The rise of the number of active companies with more than 27%, up to around 525000 in 2005, determined a moderate increase of the total bankruptcies, considering that the number of bankrupt enterprises grew with 54.4%.

The situation of bankruptcies in Romania is similar with the other countries from The Central and Eastern Europe. In these countries too the procedure for a company to file for bankruptcy is quite difficult and the recovery debts are small in comparison with value of the claims. This can be partially justified by the exaggerated fear of these states (most of them joined EU in 2004) that the integration will determine a massive growth of bankruptcies, especially SMEs; this way, they were not interested in implementing a facile mechanism of filing for bankruptcy.

The table 4 presents the situation of bankruptcies from the Eastern European countries in the period 2004-2005, divided into three groups: failed enterprises, in reorganization or closed procedure due to the lack of assets.

Table no. 4

	2004				2005			
	Failed	Reorg.	Closed procedure – lack of assets	Total	Failed	Reorg.	Closed procedure – lack of assets	Total
Czech Rep.	1,460	21	753	2,234	1,205	2	600	1,807
Hungary	7,495	24		7,519	8,099	27		8,126
Poland	889	227		1,116	637	156		793
Slovenia	437	88	264	789	449	106	178	733
Slovakia	223	0	767	990	293	0	1,352	1,645
Estonia	260			260	208			208
Latvia	1,386			1,386	647			647
Lithuania	624			624	577			577
Bulgaria	208			208	238			238
Croatia	330		1,408	1,738	212		630	842
Romania	2,031	25	264	2,320	3,171	156	255	3,582
TOTAL	15,343	385	3,456	19,184	15,736	447	3,015	19,198

Source: Coface Intercredit Romania, www.coface.ro

In 2004, we observe the big number of bankruptcies posted by Hungary, at high distance from the second country, Romania. Poland, the biggest state out of the analyzed ones, has a surprising low level of bankruptcies, of 1116 enterprises only. In 2005, the hierarchy is not changing much; Hungary has a growth of the number of bankruptcies, followed by Romania, with a considerable increase, up to the level of 3582 companies. Czech Rep., Poland, Latvia and Croatia have a strong diminution of the bankruptcies, while Slovakia has an increase from 990 companies to 1645.

In the structure, we notice, in 2004, a big number of Croatian enterprises closed due to the lack of assets (1408), against the failed companies, of 330 only. A similar

situation is also met in 2005, when the enterprises with insufficient assets are three times more numerous than the failed ones. This could reflect an inadequate bankruptcy law, with an insufficient protection provided to the creditors. A similar situation presents Slovakia, with an increasing disproportion between the two categories in 2005.

We see that we can't identify a pattern of bankruptcies in the Eastern European countries, all these posting varied levels and dynamics. For the states that joined EU at the middle of the year 2004, we notice that the fears regarding a large number of bankruptcies were not confirmed; on the contrary, most of them had a decreasing dynamic against the previous year. At the same time, the size of the country is not relevant for the number of bankruptcies, as we can see from the situation of Poland, Hungary, Latvia and Croatia.

We notice a strong growth of the number of bankruptcies in Slovakia (above 66%) which is the only that detaches itself from the countries that joined EU in 2004. Out of the other states, a similar situation can be found in Romania, with a rise of 54.4%. The states with the biggest percentage reductions are Latvia and Croatia, with more 50% decrease each. On the ensemble of the region, the dynamic of the bankruptcies is insignificant, with an increase of 0.07% in 2005 against 2004. In the structure, for the companies in judiciary reorganization, large variations can be met for Romania (increase of 524%) and Czech Republic (-90.48%). For the enterprises which are to be closed because of the lack of assets, large variations present Slovakia and Croatia, as for the failed companies, Latvia and Romania have a more accentuated variation (-53.32%, respectively +56.13%).

In order to make a correlation between the number of bankruptcies and the size of each country, one could calculate the bankruptcy rate, as a ratio between the number of bankrupt enterprises (no matter the procedure) and the number of active companies. For the previous analyzed countries, the bankruptcy rate in 2005 is calculated in the next table:

Table no. 5

	Active companies*	Total bankruptcies	The bankruptcy rate	The weight of bankruptcies in the total of the region	The weight of active companies in the total of the region
Czech Rep.	700,000	1,807	0.26%	9.41%	10.96%
Hungary	440,000	8,126	1.85%	42.33%	6.89%
Poland	3,300,000	793	0.02%	4.13%	51.65%
Slovenia	109,000	733	0.67%	3.82%	1.71%
Slovakia	434,000	1,645	0.38%	8.57%	6.79%
Estonia	96,000	208	0.22%	1.08%	1.50%
Latvia	197,000	647	0.33%	3.37%	3.08%
Lithuania	164,000	577	0.35%	3.01%	2.57%
Bulgaria	360,000	238	0.07%	1.24%	5.63%
Croatia	64,000	842	1.32%	4.39%	1.00%
Romania	525,000	3,582	0.68%	18.66%	8.22%
TOTAL	6,389,000	19,198	0.30%	100%	100%

* estimation

Source: Coface Intercredit Romania, www.coface.ro

The average bankruptcy rate in the region is 0.30%, very reduced considering the financial difficulties these companies face. A higher level than the average is posted by Hungary, Croatia, Slovenia, Slovakia, Latvia, Lithuania and Romania. Hungary and Croatia have the biggest levels, above 1%, while Poland and Bulgaria have the smallest ones.

By comparing the weight of bankruptcies in the entire region with the weight of active companies, we notice that the biggest discrepancies are presented by Hungary, which has a weight of 6.89% only of the active companies, but 42% from the total number of bankruptcies, and by Poland, with 51% from the active companies and with a weight of bankruptcies of 4% only. Out of the other states, only Romania has an unbalanced situation, with a weight of 8.22% from the active companies and 18.66% from the bankrupt enterprises. Four countries have a lower weight of bankruptcies than of the active companies (Czech Rep., Poland, Estonia and Bulgaria), while, for the other states, the biggest discrepancies in relative terms are encountered by Hungary and Croatia.

On the ensemble, we conclude that, with a few exceptions, the states that joined EU in 2004 did not face an avalanche of bankruptcies and they managed to absorb quite well the shocks of integration. Out of the two states that joined in 2007, the best position is for Bulgaria, both as the bankruptcy rate and as the dynamic of the number of bankruptcies.

In every market economy, the bankruptcy rate is a barometer of the state of wealth of the economy, but only if the bankruptcy law operates properly and cleans the business environment from the non-competitive enterprises. For the Eastern European countries, a low bankruptcy rate could hide an insufficient motivation of the government for cleaning the business environment or a bad implementation of the law in this field. For this reason, the results of this study must be cautiously analyzed when there are made appreciations regarding the competition capacity of the companies from a specific country or regarding the wealth of the business environment. Also, the results of the previous study are affected by the special situation of Poland, with more than a half of the active companies from the region but with a weight of the number of the bankrupt enterprises of 4.13%. Removing this state from the survey would increase the bankruptcy rate in the region and would change the results.

For the following period, the bankruptcy will gradually become in Romania a true barometer of the wealth of the economic system, reflecting its capacity of regenerating and removing the disequilibrium and the deficiencies from the economy. With a bankruptcy rate above the average level of the region, Romania has a low rate of recovering the debts (6.9% from the debts), but a relative short period of time of cashing a claim against other Eastern European countries (335 days). The efficiency of the current legislation will be proved in the next period, depending on the will of the authorities to successfully implement it.

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